RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

P. O. Box 1759, La Jolla, California 92038
Minimum of 26 Letters per year – $150 Annually
Registered with the Securities and Exchange Commission

March 26, 1980 **LETTER 779**

Mar. 14, DJIA 811.69; PTI 1125; A-D Ratio –22.95
Mar. 21, DJIA 785.15; PTI 1112; A-D Ratio –23.95

THE PICTURE: Ever since I started this business 22 years ago I've been hearing damn fool comments about how "they will support the market at such and such a level." Lately I've been told that "the central banks would not let gold drop below 600" because the banks would rush in to protect their reserve assets. But gold dropped below 600 like a hot needle through butter. They told me that silver would hold at 30; after all, didn't Bunker Hunt have a huge position, and wouldn't the Hunt interests support their own holdings? Silver slumped through 30 as if that number never existed.

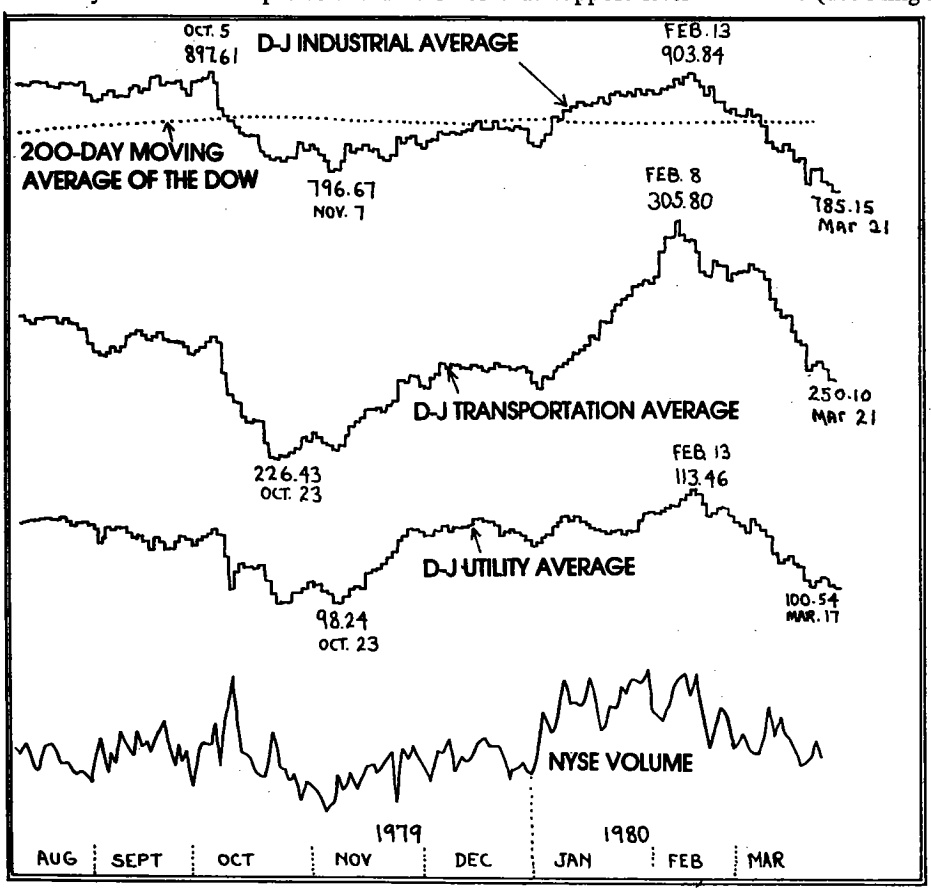
A chorus of market analysts stated that 800 on the Dow would hold. One writer even referred (a week ago) to the decline as "the 1980 version of the annual 100 point Dow drop." But 800 did not hold, and that should have surprised none of my readers. Corn to hold at 280, soybeans support at 650, the Swiss franc a steal at 630, T-Bonds (futures) to hold at 78. During the week of March 17 all the important support levels went by the wayside.

When will readers learn that the MARKETS ARE BIGGER THAN ANY MAN OR GROUP OF MEN. The markets are bigger than the US Treasury and all the wealth of Europe; they're bigger than all the assets of the Arab sheiks with their state treasuries and oil reserves thrown in for good measure! The markets represent EVERYBODY, and everybody is bigger than anybody! Understand that principle, and you'll never again get taken by the nonsense-promise that this or that support level or trendline "has to hold."

From the standpoint of the Averages (chart below) the picture is clear enough. On March 17 the D-J Industrial Average slumped 23.04 points to close at 788.65. This was the lowest close since December 1978. On the same day the Transports tumbled 8.47 to close at 253.31. This was 50 points above the December, 1978 low of 203.45 and it was 23 points above the October, 1979 low of 226.43. Thus, although Industrials wiped out all the gains of the last 16 months, the Transports did not confirm. This set the technical stage for a rally, and on March 18 the rally (from Dow 788.65) was attempted. The rally lacked steam and follow-through, and March 20 saw a sharp sell-off again.

After whipping back and forth in a range of roughly 790 to 910 for the past couple of years, investors are now conditioned to think in terms of a 1980 drop to the familiar bottom area of 790-800, followed by a rally back to the old Dow 900 zone again. A perfect round trip for the traders–but I wouldn't count on it! My own inclination is to watch for a fooler, a break in the 1978-79 pattern. And if "something new" (and deceptive) is added in 1980, my guess is that it will be a downside surprise.

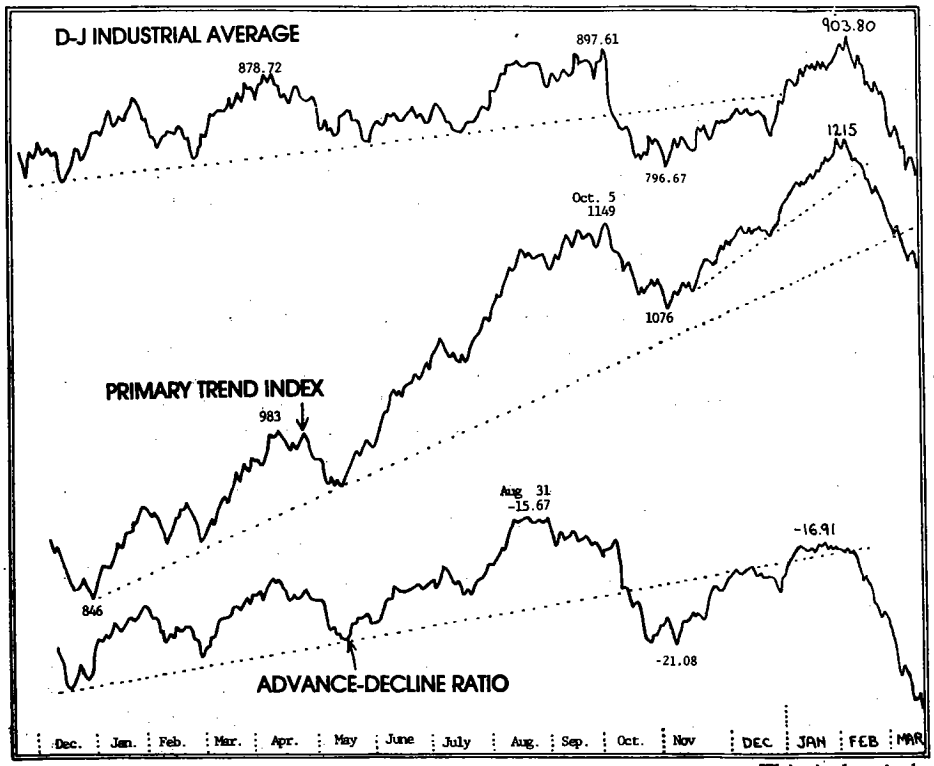
True, the market was tired at the March 17 low, and the technical indices said "oversold" at the March 17 low. But as I've noted many times before, the market can *stay oversold* for weeks on end (declining all the while).



Enough technical damage has now been done to this market to cause me to step aside–totally aside. The fact is that I'm happy to be outside looking in. Oh yes, I should mention the Utility Average (chart below). The Utilities (so far) have held above their October 24 low of 98.24, despite the rampaging interest rates (and utilities are very interest-rate-sensitive). But I would take any breaking of 98.24 on the Utility Average as a further bearish omen. Actually the Utility Average is dramatically split with the electric shares showing poor relative strength and the gas utilities showing excellent strength.

One new development deserves comment here. The NYSE short interest (announced March 20) dropped a record 10.6 million shares (or a whopping 18%) to 49.1 million shares on the latest reading. This indicates that many traders covered their shorts on the decline to Dow 788. They probably covered on the theory that the "annual decline to 790 to 800" was completed and a rally was now in order. As I said, I distrust this pat theory.

Of particular interest is that the three bellwether NYSE stocks, duPont, IBM and GM, showed a combined short interest of



1.43 million shares on February 15. A month later, on March 15, the combined short interest in these 3 bellwethers had dropped to 722 thousand shares, a decline of 50%! Clearly, the shorts thought that the decline was about over by mid-March.

Now let's turn to the daily chart of the Dow, the Primary Trend Index (PTI) and the A-D ratio. The damage to the A-D ratio since February has been severe. The decline in the A-D to minus 23.63 wiped out all the A-D action going back to late-1966! Thus, it's clear that the technical foundation of the 1976-80 action has been shaky. In a month, the collapsing A-D ratio has broken to a 3.5 year low.

The excuse for this performance is that the preferred's and money-oriented issues have been largely responsible for the A-D's negative showing. To which I answer, "Absurd. One might as well excuse a low temperature reading in a patient on the basis of anemia. But with 'tired blood' the whole body will soon be affected." The poor monetary environment (as reflected in slumping financial issues) will eventually affect most equities. And that is probably what we are witnessing on Wall Street now.

The PTI has dropped from a value of 1215 (recorded on February 8 and again on February 13) to a low of 1112 registered on March 21. This is an almost striaght line decline of 103 points. For comparisons, the so-called "Massacre" of October-December, 1978 erased 122 points from the PTI, while the "Massacre" of September-November, 1979 wiped 73 points from the PTI.

As you can see, the PTI has now broken below all rising trendlines of the past 2 years, and the possibility of a new major declining trend in the PTI must be conceded. In previous instances since 1978, each drop in the PTI was followed by bullish patterns of successive rising peaks and bottoms. Therefore, what I want to see is whether the PTI is able to trace out a bullish series from here or whether this indicator is beginning a long descent to the downside.

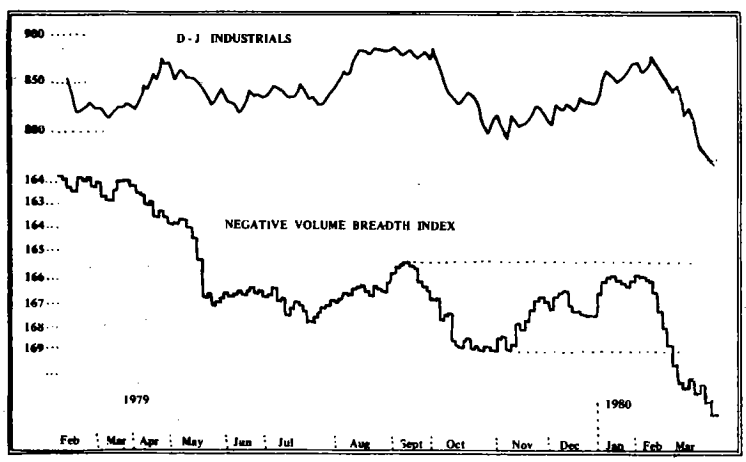
INVESTMENT POLICY: Our current investment policy could not be simpler; it can be expressed in four words, "Basically in treasury bills." Buy the T-bills (for convenience) through your bank or brokerage firm (in answer to many questions, if the bank or brokerage house goes "belly-up," the bills are still yours; they are an entry on the Fed's books in your name.) Buy either the 91-day or the 6-month bills. Stay with these bills. Don't buy other kinds of short-term (or long-term) debt. These bills represent the first obligation of the US Government (after salaries, of course). They are as good as cash. They are outside the banking system. They do not have to be insured. You do not pay state taxes on the income. They are sold on a discounted basis. And they offer fat yields of better than 14%.

To those who have 10% or so in gold coins, this should round out your present very simple investment position (along with your house, your car, and so forth). If you do not own gold, sit tight a while. I don't see any rush to buy gold at this time.

NEGATIVE VOLUME-BREADTH INDEX (NVBI): One of the indices that I have followed for many years was formulated by the late Paul Dysart of Trendways. This index is based on the following concept: large investment interests prefer doing their business in quiet markets. Smaller (or less sophisticated) interests are drawn to the market (on both the upside and the downside) by activity—or rising volume.

Dysart was interested in developing an indicator that would tell him what large investment interests are doing. Since large interests like the quiet side of the market, Dysart reasoned that they would tend to act during days when NYSE volume was BELOW that of the previous day. To track this sophisticated action, Dysart developed the NVBI. This index uses the advance-decline differentials, but only on days when volume on the NYSE is below volume of the preceding day. The differentials are plotted on a cumulative line as shown on the chart. Remember, this chart shows the Dow and the NVBI only on declining-volume days. Thus, it is theoretically possible for a whole week to go by (expanding volume) in which no entry would be made on this chart. Another week could have an entry (all contracting volume days) on each and every trading day.

In my experience of two decades using the NVBI, I find that the index pertains basically to the breadth of the market (i.e., the A-D ratio), rather than the Averages. Thus, during the period of February to July, 1979, the NVBI was discouraging for breadth



in that the Index was in a well-defined declining trend. From July to September, the NFBI rallied, and the breadth indications brightened. But from September to October the NVBI caved in to new lows, and this occurred simultaneously with the 1979 "October massacre."

During the October, 1979 to January 1980 period the NFBI entered into a broad and very promising rally phase. I was particularly interested to see whether the index would develop the strength to break out (during January) above the important July, 1979 peak. Such a breakout would have constituted a major bull signal under this study. Unfortunately, as you can see, the rally into January ended in a dramatic failure. The NVBI formed a "double top" just below the July peak, then crashed to a brand new low. This latest new low is most discouraging. It constitutes an important bear signal for breadth.

What is the February-March action of the NVBI telling us? Consider this. Important bull trends tend to push stocks up on expanding volume. But a vital gauge of bull market activity is—what happens during the lower volume period following a high volume rally. If, after the rally, stocks tend to hold their gains as volume recedes, this is very bullish. It is an indication that shortly prices will rally again to new highs.

However, if, after a high volume rally, stocks tumble on lower volume we have a picture of a market which can not sustain its gains. Such a market is technically weak, and is most apt to drop to lower levels. The rallies in this kind of market will not hold, and the breadth of the market will deteriorate.

So this is the kind of action that the NVBI measures. On this basis, the important new February-March lows in the NVBI tell us that this market has not sustained its A-D ratio gains. From the standpoint of the majority of issues on the NYSE, that constitutes bearish action.

Ultimately, the market will reach a level in which the NVBI will start building a bullish structure again. When that happens, Wall Street will develop a broad bullish "feel" rather than a selective and erratic appearance based on the action of one or two explosive groups.

MAJOR BOTTOM - WHEN, WHERE ? You all know the classic question about the water glass and whether one should view it as "half full or half empty." Well, let's turn the stock market around, and instead of talking about the chances of a major cave-in, let's talk about the chances of a major bottom, and an historic buying opportunity.

Back in Letter 726 and again in Letter 769 I discussed an indicator that I have plotted and watched for many years. This indicator is based on proprietary ratings on a list of over 300 NYSE stocks. Although this indicator is not particularly useful at tops (because tops tend to be extended), the indicator is outstandingly useful in identifying major bottoms (as opposed to secondary bottoms).

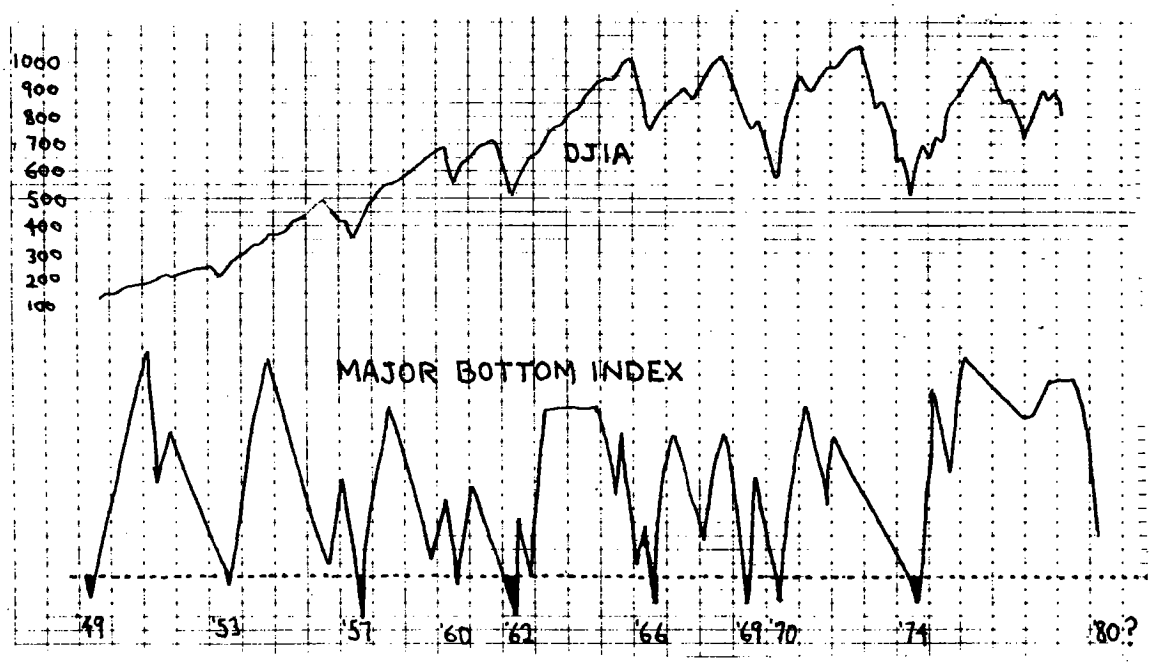
The accompanying chart shows the bottom indicator from the period of 1949 to 1980. This is not a "retroactive reading", it is a record of the indicator which was actually kept at the time. Note that there have been 9 instances in which the bottom indicator dropped below the horizontal dotted line into the "major oversold area." Each of these major bottoms is delineated by a solid black section in the index and the *dates* for each of these bottoms is included on the chart.

Since 9 major bottoms have materialized during a 30 year span, we can say that the average span between bottoms is approximately 3.33 years. But note that the last great bottom occurred in late-1974. This is more than 5 years ago, and it is the longest time span since World War II.

The peak for the bottom indicator arrived in early 1976, as you can see on the chart. But what particularly interests me now is the fact that the bottom indicator has broken below its mid-1975 low and is now lower than any time in the past 5 years. "Normally," once the bottom indicator gets this low (to a semi-oversold condition) the market will rally for a few weeks or so and then head down to major over-sold territory.

Based on past performance, however, the odds favor a good rally BEFORE the final descent to an historic low. Very frankly, I don't know HOW the bottom indicator is going to get below the dotted line. I don't know whether the market will rally first and then make the final plunge or whether the market will just continue down. But I do feel strongly that 1980 is it! I feel strongly that 1980 will see the bottom indicator make its first major low since 1974.

Question: Russell, in studying the chart I would think that an investor since 1949 would have done better simply to limit buying of stocks to the times when the bottom indicator dived below the dotted line, and then to sell out near the indicator peaks. Why buy at any other time?



Answer: Theoretically, you are correct. Results for MOST people would be far better if they had bought stocks ***only*** at the historic lows as identified by the bottom indicator. But psychology works against us. There is the matter of impatience, greed, fear and disbelief. The pressure in this business is always to "do something," to "get with it," "to beat inflation," to "make a killing." Also, it is always EASIEST to buy when this indicator is near the middle to the top of its range. The market *feels better* in those areas. And it is hardest to buy when the indicator is below the dotted line–in the buy zone. Because at those times the market is in a panic phase, and you're wondering whether Wall Street and the nation will survive.

So, I'm telling subscribers now to steel themselves, to prepare themselves for the possibility of a major bottom somewhere ahead as identified by this indicator. If and when this indicator drops below the dotted line, it's going to "feel" very hard to buy stocks. Every fiber in your system is going to be telling you that stocks and Wall Street are finished. At thattime you are going to have to go against your emotions. But that will be the ideal time to buy. So start getting yourself ready–emotionally.

BONDS & STOCKS: I've tried to keep my subscribers abreast of the critical developments in the bond market. I've tried to show subscribers the importance of bonds in the whole financial structure of this nation. I've tried to show readers why accelerating inflation in the US would ultimately sow the seeds of its own destruction. Why, how? Because the US has huge multi-trillion dollar CAPITAL MARKETS. Destroy the capital markets and you tear the foundation out from under the house. Smash the bond and mortgage markets and you drain off the life-blood of the US economy.

My friend Bill Bretz (Juncture Recognition, Box 1209, Pompano Beach, FL 33061) is a true researcher. In his latest report he shows the historical correlation between major bond declines and subsequent stock market declines. This listing (courtesy Bretz) shows 15 previous important declines in the D-J 40-Bond Average. The declines range from the comparatively mild 1923 decline of 7% in bonds to the drastic 1929-32 decline of 34%. Note that each decline in the bonds was accompanied or followed by a decline in stocks. But the fascinating fact is that in every single instance the decline in stocks was greater in percentages than the decline in bonds. In other words, whatever negative influence hurt the bond market, that influence hurt the stock market to a GREATER degree.

Bear Market Period	Dow Jones % Loss	40 Bond Average % Loss
1916-17	40%	15%
1919-21	47%	19%
1923-23	19%	7%
1929-32	89%	34%
1937-38	49%	21%
1938-42	41%	10%
1946-49	24%	12%
1953-53	13%	10%
1956-57	19%	17%
1960-60	17%	11%
1961-62	26%	4%
1966-66	25%	12%
1968-70	36%	23%
1973-74	45%	15%
average	35%	15%

Since 1977 the D-J Bond Average (it is now the 20-Bond Average rather than the 40-Bond Average) lost a bit more than 30%. If you want to use the Dow peak of 1015.79 to the 1978 low of 742.12, you have a loss of 26.8%. That suggests that the final Dow low should at least crack the 1978 low of 742.12 if the historical relationship is going to hold up. But if you take the 1978 peak of 907.74 as the Dow peak, then you can expect an ultimate Dow low of under 600.

At any rate, this study suggests that the stock market has NOT yet reflected the damage which we see built into the bond market. The effects of inflation and illiquidity (the twin demons of the bond market) have yet to hit the stock market with the force suggested by the bond-stock percentage figures. Only time will tell whether the message of this chart is fated to come to pass. My own feeling is the statistical relationships on this chart will hold true.

PURCHASING POWER: Question: Russell, I note that you have been showing ominous charts of gold for the last few months, and you have been implying that gold was going down. But I'm not a trader, and moreover, I don't trust paper dollars. Are you implying that we should sell our gold for depreciating paper? I don't understand your attitude, since you have always been a gold man!

Answer: The operative phrase is "purchasing power." We are trying to maintain our purchasing power in the face of a Government that for 25 years has been pursuing a policy of destroying the currency. But it is crucial to remember that no market goes up or down in a straight line. Furthermore, as we have seen in stock markets (1973-74), in gold markets (1973 to the present), and in bond markets (1976 to the present), the moves in various items can be enormously profitable to people positioned correctly and devastating to those positioned on the wrong side of the market.

The purchasing power of everything fluctuates. Gold has no conscience, dollars have no conscience nor do stocks. All marketable items move up and down in relation to investor preference and relative value. For instance, when gold was $100 it was under-valued and unwanted. When gold was $850 it was over-valued and on the covers of Time and Newsweek. Bonds in early 1977 were wanted and in view of inflation were over-valued. By early 1980 bonds were despised and (although we can't prove it yet) perhaps under-valued.

Markets are now buffeted by new Government edicts, frightening international developments, political pressures and monetary emergencies. There is no such thing as a **safe** investment any more, and some claim that there is no such thing as an "investment" at this time. Inflation and a feeble and immoral Government has made speculators of us all. Who would have thought say 10 or 15 years ago that money in the bank or in a Government bond would be a rank speculation in 1980. But that's just what they are, and it's folly to pretend they are anything else.

It is well to remember that we buy our food and pay the rent with those despised **dollars**, and that dollars are still legal tender in the US. They represent purchasing power, and no amount of cynicism will change that. We buy gold and bonds and stocks and commodities with dollars, and ultimately we change everything back to dollars in actuality or at least mentally ("I have $50,000 worth of gold" or "I have $100,000 in Exxon")

We can't always be successful at it, but ideally what we should be attempting is to purchase marketable items at the under-valued and unwanted side of the ledger and to sell those items at the over-valued "much loved" side of the ledger.

My feeling now is that bonds and then stocks are gradually moving into the undervalued side of the ledger, but that they may have more to go as they become even more unwanted and more undervalued. At some point, they will be at super-bargain levels, and at that point I will want to be in them with my subscribers. That's the place where we will swap dollars for stocks and dollars for bonds. But in the meantime, the "lowly" dollar has not been a bad place to be. And of course, the question can be asked, "If the dollar is so lowly, why are they paying us 17% to rent them?" And by the way, did you ever think of interest as "rent paid for dollars." Because that's exactly what it is.

NOTES & QUOTES: From our "Can the US Survive?" department. So far only 25% of the Iranian diplomats that were ordered out of the US have actually left. Since the taking of the hostages, 20,000 (that's not a mistake) additional Iranians have entered the US!

* *

From our "Treasury Tales" department: The Treasury will be borrowing $18.5 billion in the current quarter, 50% more than the same period last year. The Government will be borrowing $9 billion more in the June quarter, whereas in the last 4 years they were paying off debt in the June quarter. Note: on March 20 the money markets were buffeted when the Treasury announced it was going to raise an additional $12 billion in the next two weeks due to "somewhat increased cash needs"! According to the Bond Buyer, the latest Administration anti-inflation move was brought on by the fear that soon there would be no market to sell US Treasuries in. They also felt that the "real reason" for the new import fee on oil was simply that the *Government needs the money!*

* *

Roughly 60% of the so-called "windfall oil tax" will go to reducing income taxes and for handouts to lower income Americans. Thus, the bill becomes a "windfall US Government bonus," one of the greatest boondogles in American history. It's almost beyond belief, but instead of using this dishonest tax for research and production of alternate energy, the great bulk of the money will be squandered. As I've so often said, in a democracy the people vote for and deserve what they get.

* *

Jim Blanchard raves about Montreal, promises me that it is "the Paris of North America." I'll take his word for it, and I'll be there for the 6th Annual "Offshore Conference" of the National Committee for Monetary Reform. Speakers will include Milton Friedman, Tony Boeckh, Jim Sinclair, Julian Snyder, Monte Guild, Howard Ruff and many more–including my old friend Tom Holt, a true original thinker and a rarity at any conference (and I'm sure Tom is going to talk about deflation). The conference is set for June 5-8 at the Queen Elizabeth Hotel (write NCMR, 8422 Oak St., New Orleans, LA 70118 for info).

* *

Californians have had it with state super-spending. And they are going to do even more about it (following Proposition 13). Now we've got Proposition 9, which will cut our state income taxes in half and get rid of billions in state deadwood.Our leader here isn't Jerry Brown (in case you haven't heard), it's "The Grim Slasher," Howard Jarvis. Jarvis doesn't mince words, and he's scared the hell out of all the politicians in California. Of the State Legislature, he calls them "faceless, stupid bureaucrats..... just like 120 hogs at the trough pushing each other out of the way to get at the corn." I met Jarvis at the Ruff Conference two weeks ago. "Howard," I asked, "how can we get you from California to Washington!" Here's a news clip from our local paper on Jarvis and Prop. 9.

Prop. 9 Proving Too Popular for Political Challenge

Arguments Parallel Prop. 13; Jarvis Expects 2-1 Win

By TIM O'REILEY
SAN DIEGO DAILY TRANSCRIPT Staff Writer

Howard Jarvis has become an awesome political force without even having his name on a ballot; incredible to people outside California, horrifying to some in the state, the messiah of lower taxes to many more.

His property tax-cutting Prop. 13 shook state government two years ago because of both its drastic cut in tax revenues and its resounding approval by the voters. But it was not enough for the now 76 year old Jarvis

* *

Don't look now, but I sense the press (and maybe everyone else) is becoming fed up with Jimmy Carter. I firmly believe that Carter looks good in the primaries because nobody can stomach Kennedy. But I'm actually beginning to think that Reagan has a chance to take the election, particularly if he picks an outstanding Vice President (that is imperative). One by one the major national columnists are attacking Carter, each in his own way (and that includes Joe Kraft, William Safire, and even Arthur Schlesinger Jr.). Following is an interesting and insightful Safire piece, well worth reading.

This week's next year's budget is better than last week's next year's budget, but I wonder what next week's next year's budget will be?

The reason nobody believes President Carter will stick to his Anti-Inflation Plan No. 4 is the same reason nobody put much faith in his previous three plans: When public opinion shifts, so will he. His single consistent sail on a sea of inconsistency is a determination to stay in office.

Last summer, when his main worry was a challenge from the Democratic left, behind Sen. Kennedy, growth in federal domestic spending was allowed to roll merrily and inflatingly along, with a downhold on defense spending. Few guns, plenty butter.

Then, last fall, when his political centerpiece was a SALT Treaty with friendly Soviets, Carter was willing to increase defense spending to buy senatorial votes on SALT. Some guns, plenty butter.

Come winter, with an appeasement-emboldened Soviet Union marching into Afghanistan, hawkishness became popular. Accordingly, Carter prepared a budget that did not slow down domestic increases but promised a rise in real defense spending of nearly 5 percent. Plenty guns, plenty butter.

When that surrender to inflation caused a bond market crash, and when Reagan replaced Kennedy as his main political threat, Carter sensed that the popular mood called for spending cutbacks. Moreover, as the Soviets had not invaded anybody else lately, last season's international crisis could be put on a back burner. The result last week was a re-revised budget featuring no butter and no guns.

This weathervane philosophy is beginning to embarrass even Jimmy Carter. When the financial markets signaled a fear of incipient panic, and when all that was needed was a scandal in the money-market funds or a failure among the savings and loans institutions to start a run for the hills, the President dutifully declared a "crisis" and threw out his latest budget.

courtesy NEW YORKER

LATE MARKET NOTES: Prognosis–poor. My exponential moving averages of the Dow rendered a major sell signal on March 21 when the 13-week MA (at 840.12) broke BELOW the 50-week MA (at 843.37). All three Dow MA's are now negative and declining. On March 21 the PTI sank to a new low of 1112, down 103 points from its peak. Also on March 21 the Dow Industrial and Transportation Averages broke to new lows for the move. Thus everything appears in gear on the downside.

The market, moreover, has been declining on declining volume–action that I never particularly care for. It means that prices are wilting (note IBM) but no one is getting out! BEST BET–stand aside, wait for the long-promised major cyclical bottom. The odds say it should arrive this year. With a record margin debt on the NYSE, with an 18% March drop in the NYSE short interest, with the odd-lotters turning more optimistic (they're cutting back on their selling), this market could be ready to s-l-i-d-e.

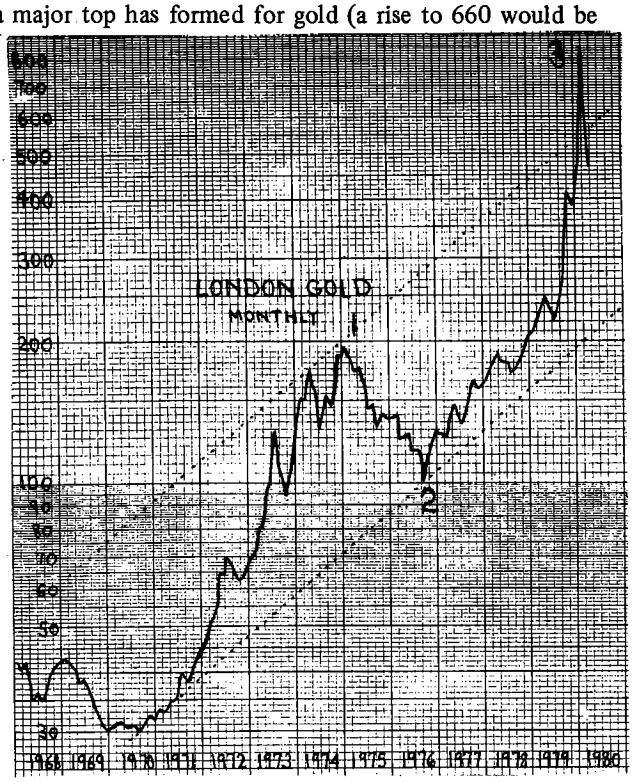
GOLD: Gold broke last week to the 474 level (London fix), down from 850 for a drop of 376 points. This *panic* smash could see a recovery of as much as 50%, which would take gold back to 662. A weaker 33% recovery could take gold back to 599. By my reckoning, gold is now in a major corrective phase, following its second wave peak (point 3 on the semi-log chart). Since leg 3 blew gold out of (above) its major rising trendline, this was a case of too much steam, too much enthusiasm. The final correction result could easily be a return back to the middle of the rising channel (see chart bottom left). Such a return would take gold to the 350 level–in due time.

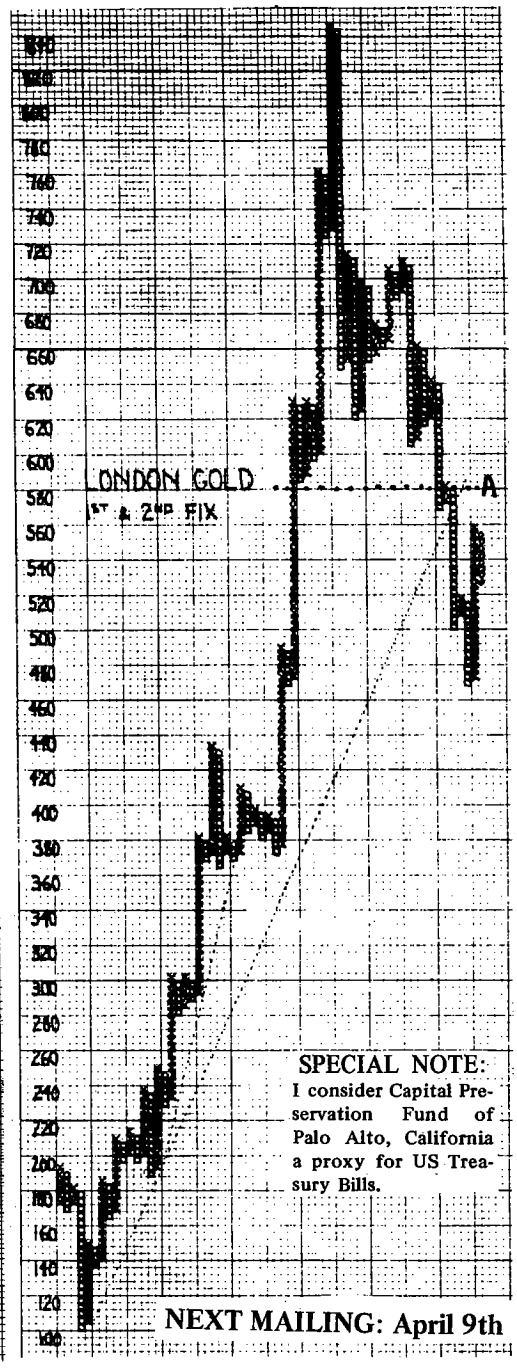
The point & figure chart (right) shows gold in a major topping formation. When the support ("A" on chart) was shattered, I felt the top was completed and the support line then became a zone of resistance. Thus, 580 should now offer a good deal of resistance to the recovery.

My P&F count shows a vertical (potential) downside count of 370 for gold. On a horizontal count I get 336. South African Tony Henfrey (Henfrey's Gold Letter, PO Box 5577, Durban 4000, S.A.) is an excellent gold analyst and chartest. In his latest report, Tony concedes that a major top has formed for gold (a rise to 660 would be needed for a reversal) and Tony sees an ultimate downside target of 250-290.

I consider gold too volatile and "whippy" to take positions in now, and I am waiting to see whether we get some calmer weather–which we will have in due time. My 5-week exponential moving average of gold is now 556, below the 13-week MA which stands at 594. The long-term or 50-week MA is at 448, creeping higher at the rate of about 3 points a week.

I know no better way of losing money than "in-and-out" trading in this type of market. So be advised, and act accordingly.





SPECIAL NOTE: I consider Capital Preservation Fund of Palo Alto, California a proxy for US Treasury Bills.

NEXT MAILING: April 9th